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Douglas Wilson & Company
Montana State Lottery audited financial statements, June 30, 1991

MONTANA STATE LOTTERY

AUDITED FINANCIAL STATEMENTS

June 30, 1991

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MONTANA STATE LOTTERY

AUDITED FINANCIAL STATEMENTS

June 30, 1991

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STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
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LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

DEPUTY LEGISLATIVE AUDITORS:

MARY BRYSON
Operations and EDP Audit

JAMES GILLETT
Financial-Compliance Audit

JIM PELLEGRINI
Performance Audit

September 1991

The Legislative Audit Committee
of the Montana State Legislature:

Enclosed is the report on the audit of the Montana State Lottery for the year ended June 30, 1991.

The audit was conducted by Douglas Wilson & Company, PC, under a contract between the firm and our office. The comments and recommendations contained in this report represent the views of the firm and not necessarily the Legislative Auditor.

The agency's written response to the report recommendations is included in the back of the audit report.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

MONTANA STATE LOTTERY

COMMISSION MEMBERS AND ADMISISTRATIVE OFFICIALS

JUNE 30, 1991

Commission Members	Residence
Ward Shanahan - Chairman	Helena
Rebecca Erickson	Glasgow
William Ware	Helena
Gary Rebal	Great Falls
Dwaine Iverson	Shelby

Administrative Officials

Zoann Attwood, Director

L. John Onstad, Security

Gerald J. LaChere, Operations

Janet Drexel Bone, Marketing

MONTANA STATE LOTTERY

INTRODUCTION AND BACKGROUND

June 30, 1991

INTRODUCTION

We performed a financial-compliance audit of the Montana State Lottery for the fiscal year ended June 30, 1991, and issued an opinion on such. The scope of our services is defined in our contract with the Office of Legislative Auditor, as supplemented by certain requirements included in the bidders information.

As a result of our audit, we have issued an independent auditor's report on compliance with laws and regulations and internal control structure related matters which includes certain required comments.

BACKGROUND

The Montana State Lottery was created in November 1986 by a referendum vote of the people of Montana. The "Montana State Lottery Act of 1985" appears as Chapter 669 of the 1985 Montana Session Laws. The general purpose is to allow lottery games in which the players purchase from the state, through the administration of the Montana State Lottery, a chance to win a prize. Disposition of revenue is a minimum of 45 percent for prizes, a maximum of 10 percent for commissions to sales agents, payment of operating expenses, and the remaining revenue to the Superintendent of Public Instruction.

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Commissioners
Montana State Lottery
Helena, Montana

INDEPENDENT AUDITOR'S REPORT

We have audited the balance sheet of the Montana State Lottery, a component unit of the State of Montana as of June 30, 1991, and the related statements of revenue, expenses and changes in retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Montana State Lottery as of June 30, 1990, were audited by other auditors whose report dated September 13, 1990, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 1991 financial statements referred to above present fairly, in all material respects, the financial position of the Montana State Lottery as of June 30, 1991, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

Douglas Wilson & Company, P.C.

September 13, 1991

Douglas Wilson & Company, PC
Established 1913

MONTANA STATE LOTTERY

BALANCE SHEETS AS OF JUNE 30, 1991 AND 1990

ASSETS	6/30/91	6/30/90
Current Assets:		
Cash and Cash Equivalents	$ 975,605	$ 1,341,235
Accounts Receivable	602,632	771,995
Inventory	173,921	108,456
Prepaid Expenses	8,088	1,928
Employee Advances	5,000	5,940
	1,765,246	2,229,554
Fixed Assets:		
Computer, Furniture and Equipment	762,715	772,183
Computer Software	840,400	840,400
	1,603,115	1,612,583
Less: Accumulated Depreciation and Amortization	(1,091,024)	(846,062)
	512,091	766,521
Other Assets:		
Multi-State Lottery Receivable	542,809	--
Advertising License Fee, Net of Accumulated Amortization of $30,261 in 1991 and $47,857 in 1990	21,863	52,143
	564,672	52,143
	$ 2,842,009	$ 3,048,218
LIABILITIES AND FUND EQUITY		
Current Liabilities:		
Long-Term Debt Due Within One Year	70,033	165,284
Accounts Payable and Accruals	340,871	329,526
Due to State Superintendent of Public Instruction	1,092,397	1,519,520
Due to Other State Agencies	97,048	76,430
Accrued Compensated Absences	99,549	94,392
Estimated Prizes Payable	994,758	695,144
Deferred On-line Revenue	19,629	20,029
Allowance for Ticket Returns	129,751	147,893
	2,844,036	3,048,218
Fund Equity (Deficit)		
Unreserved Retained Earnings (Deficit)	(2,027)	--
	$ 2,842,009	$ 3,048,218

See the accompanying notes to the financial statements.

MONTANA STATE LOTTERY

STATEMENTS OF REVENUE, EXPENSE AND CHANGES IN RETAINED EARNINGS
FOR FISCAL YEARS ENDING JUNE 30, 1991 AND 1990

	6/30/91	6/30/90
Operating Gross Revenues:		
Instant Ticket Games	$ 8,170,377	$ 11,619,715
On-Line Games	15,761,001	9,890,070
Gross Ticket Revenues	23,931,378	21,509,785
Cost of Ticket Revenues:		
Instant Ticket Prize Expense	4,672,276	5,549,622
On-Line Ticket Prize Expense	6,986,546	4,639,706
Retailer Commission	1,346,955	1,352,477
Cost of Tickets Sold	503,516	552,884
On-Line Vendor Fees	3,539,506	2,358,147
Total Cost of Ticket Revenues	17,048,799	14,452,836
Net Ticket Revenues	6,882,579	7,056,949
License Fees	4,350	4,150
Net Operating Revenue	6,886,929	7,061,099
Operating Expenses:		
Advertising	622,030	779,968
Amortization	198,341	204,747
Bad Debt	668	--
Communications	73,970	67,710
Contractual Services	368,274	364,667
Depreciation	119,055	118,258
Management Service Fee	78,627	78,172
Multi-State Operating Fees	33,807	25,788
Personal Services	966,940	919,490
Repairs and Maintenance	77,878	83,709
Supplies and Materials	46,326	103,051
Utilities and Rent	96,536	95,280
Travel	35,054	41,706
Other	21,245	29,964
Total Operating Expenses	2,738,751	2,912,510
Net Operating Income Before Non-Operating Revenues Expenses and Transfers	4,148,178	4,148,589

See the accompanying notes to the financial statements.

MONTANA STATE LOTTERY

STATEMENTS OF REVENUE, EXPENSE AND CHANGES IN RETAINED EARNINGS
FOR FISCAL YEARS ENDING JUNE 30, 1991 AND 1990

	6/30/91	6/30/90
Non-Operating Revenues (Expenses):		
Interest Earnings	40,371	25,825
Gain (Loss) on Sale of Assets	2,927	(4,987)
Other	6,953	--
Interest Expense	(119)	(540)
Total Non-Operating Revenue (Expenses)	50,132	20,298
Net Operating Income Before Transfers	4,198,310	4,168,887
Operating Transfers to State Superintendent Of Public Instruction	4,200,337	4,168,858
Net Income (Loss)	(2,027)	29
Retained Earnings, Beginning of Period	--	(29)
Retained Earnings, End of Period	$ (2,027)	$ --

See the accompanying notes to the financial statements.

MONTANA STATE LOTTERY

STATEMENTS OF CASH FLOWS
FOR THE FISCAL YEARS ENDING JUNE 30, 1991 AND 1990

	6/30/91	6/30/90
Cash Flows from Operating Activities:		
Net Operating Income Before Non-Operating Expense and Transfers	4,148,178	4,148,589
Adjustment to Reconcile Net Operating Income to Net Cash Provided by Operating Activities:		
Amortization and Depreciation	317,396	323,005
Book Value of Assets Disposed	773	--
Decrease (Increase) In:		
Accounts Receivable	169,358	(107,498)
Inventory	(65,465)	25,518
Prepaid Expenses	(6,160)	(590)
Employee Advances	940	(940)
Multi-State Lottery Receivable	(542,809)	--
Increase (Decrease) In:		
Accounts Payable and Accruals	11,345	243,863
Due to State Superintendent of Public Instruction	(427,123)	--
Due to Other State Agencies	20,618	11,008
Accrued Compensated Absences	5,157	19,603
Estimated Prizes Payable	299,614	(809,999)
Deferred On-Line Revenue	(400)	20,029
Allowance for Returned Tickets	(18,142)	(140,071)
	3,913,280	3,732,517
Cash Flows from Non-Capital Financing Activities:		
Operating Transfers Out to State Superintendent of Public Instruction	(4,200,337)	(2,955,748)
	(4,200,337)	(2,955,748)
Cash Flows from Capital and Related Financing Activities:		
Payment of Long-Term Debt	(95,251)	(189,204)
Acquisition of Fixed Assets	(48,317)	(66,033)
Proceeds from Sale of Fixed Assets	17,790	7,716
Interest Paid on Fixed Assets Acquisition Contract	(119)	(540)
Other	6,953	--
	(118,944)	(248,061)
Cash Flows from Investing Activities:		
Interest Earned on Cash Equivalents	40,371	25,825
Net Increase (Decrease) In Cash and Cash Equivalents	(365,630)	554,533
Cash and Cash Equivalents at Beginning of Year	1,341,235	786,702
Cash and Cash Equivalents at End of Year	$ 975,605	$ 1,341,235

See the accompanying notes to the financial statements.

Note 1: Summary of Significant Accounting Policies:

A. Organization - The Montana State Lottery was created in November 1986 by a referendum vote of the people of Montana. Section 23-5-1001, Montana Code Annotated (MCA) establishes the provision of the code under which the Montana State Lottery operates. The Montana Lottery is operated by a five member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games with other lottery states and prepare financial reports.

Disposition of revenue is a minimum of 45 percent for prizes, a maximum of 10 percent for commissions to sales agents, payment of operating expenses and the remaining revenue to the State Superintendent of Public Instruction.

The State of Montana provides certain services to the Lottery covering: central payroll, accounting, self-insurance, communication, motor pool and various other services. The costs charged to the Lottery for these services were approximately $1,320,000 and $1,265,000 in fiscal years ended June 30, 1991, and 1990, respectively.

B. Reporting Entity - The Lottery, a division within the Montana Department of Commerce, is considered a component unit of the oversight unit known as the State of Montana. There are no component units to be included with the Lottery as a reporting agency.

C. Basis of Accounting - The Lottery utilizes the accrual basis of accounting and is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations: a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate.

D. Revenue Recognition - Sales of lottery instant tickets are made to licensed retailers, who in turn sell the tickets to the public. Retailers receive a minimum 5 percent commission. Revenue is recognized when the tickets are delivered to the retailers. Tickets not sold by the retailer

may be returned to the Lottery for credit. Sales are reduced for estimated ticket returns.

Sales of on-line lottery tickets, starting in early November 1989, are made by licensed retailers to the public with the use of computerized terminals. Retailers receive a 5 percent commission. Revenue is recognized on drawing dates. Tickets sold in advance for future drawing are recorded as deferred revenue until the ticket becomes valid for a drawing.

E. **Prizes** - Prize expense is recognized based on the predetermined prize structure for each instant ticket and on-line game. Free tickets are recorded as a reduction in revenue and not as prize expense.

F. **Cash and Cash Equivalents** - Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments in the State's short-term investment pool and cash on deposit with the State Treasurer which is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily. See the statewide audit for the level of risk associated with the cash and cash equivalents.

Cash is as follows:

	6/30/91	6/30/90
Cash on deposit with State Treasurer	$ 564,655	$ 506,585
Cash on deposit in short-term investment pool	400,800	824,500
Cash in revolving check account	10,000	10,000
Petty cash	150	150
	$ 975,605	$1,341,235

G. **Inventory** - Inventories consist of tickets and supplies. Ticket inventory includes lottery instant tickets stored in the warehouse and with marketing representatives. The tickets are carried at cost using the specific identification method. Tickets are charged to cost of sales when sold and unsold tickets are charged to cost of sales upon the end or cancellation of a game.

Supply inventory is carried at cost and expensed as used.

H. **Fixed Assets** - Fixed assets are recorded at cost and depreciation or amortization is computed using the straight-line basis over the following estimated useful lives:

Computer	6 years
Software	5 years
Vehicles	3 years
Furniture and equipment	6 - 10 years

I. **Advertising License Fee** - Advertising license fee is recorded at cost and amortization is computed using the straight-line basis over a 3-year estimated useful life.

J. **Accounts Receivable** - Accounts receivable represent amounts due the Lottery for purchased tickets. These amounts are electronically transferred within 28 to 34 days of instant tickets purchased, and weekly for on-line tickets purchased. The Lottery grants credit to licensed retailers throughout the State of Montana. Bad debts are nominal and no allowance for doubtful accounts has been established.

K. **Compensated Absences** - State employees earn vacation leave ranging from 15 to 24 days per year depending on the individual's years of service. Vacation leave may be accumulated to not exceed 2 times the maximum annual leave. Sick leave is earned at 12 days a year with no maximum accumulation. Upon retirement or termination, an employee is paid 100 percent for unused vacation and 25 percent for unused sick leave.

L. **Joint Venture - Multi-State Lottery Association** - In November 1989, the Montana State Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. Each lottery participating in MUSL is represented on the Board of Directors. The Board's responsibilities are to initiate, promulgate, and administer a multi-state lottery game for the mutual benefit of the member lotteries.

As of June 30, 1991, MUSL's unaudited financial information is as follows:

Total Assets	$ 249,369,459
Total Liabilities	249,271,289
Fund Balance	98,170
Total Liabilities and Fund Balance	$ 249,369,459
Total Revenue	$ 1,709,087
Total Expenses	1,737,616
Excess (Deficit) of Revenue Over Expenses	$ (28,529)

Note 2: **Long-Term Debt** - Long term debt consist of the following:

	6/30/91	6/30/90
Installment purchase of Instant Lottery System software payable in monthly payments of $11,672 including no interest through March 1990 and $23,344 including no interest through February 1991.	$ 70,033	$ 163,411
Lease purchase of copier payable in monthly payments of $249 including interest at 16.7% through February 1991.	--	1,873
	70,033	165,284
Less portion due within one year	70,033	165,284
Long-term portion	$ --	$ --

Note 3: **Obligation to Transfer Funds to State Superintendent of Public Instruction** - The remaining portion of gross revenue not used for payment of prizes, commissions, and operating expenses is transferred quarterly from the Lottery to the State Superintendent of Public Instruction. At June 30, 1991 and 1990, $1,092,392 and $1,519,520 respectively, were payable to the State Superintendent of Public Instruction. Operating transfers of $4,200,337 and $4,168,858 were reported during the fiscal years ended June 30, 1991 and 1990, respectively.

Note 4: **Lease Commitments** - The Lottery has a lease for office and warehouse space in Helena, Montana. Lease expense included in the operating expenses is $81,600 for the fiscal year ended June 30, 1991, and 1990. Minimum future lease payments, under all non-cancellable leases, are as follows:

1992	$54,400

Note 5: **Employee Retirement System** - The Lottery and its employees make contributions to the Montana Public Employees Retirement System (PERS) defined benefit plan. The Lottery is required to contribute for full-time employees at the rate of 6.417 percent of annual compensation under state statute. Employees are required to contribute 6.30 percent of annual compensation. Part-time employees have an option to belong to the retirement plan, depending upon hours worked. The Montana Public Employees' Retirement System does not segregate financial information for each participating entity.

The total number of Lottery employees covered during the year ended June 30, 1991 and 1990 was 36 and 37, respectively. The total payroll for the employees was $782,269 in 1991, and $739,699 in 1990. The Lottery's contributions were $50,093 and $44,919 for the years ended June 30, 1991, and 1990, respectively. Benefit eligibility is age 60 with at least 5 years of service; age 65 regardless of service; or 30 years of service regardless of age. Actuarially

reduced benefits may be taken with 25 years of service or at age 50 with at least 5 years of service. Monthly retirement benefits are determined by taking 1/56 times the number of years of service times the final average salary. Members' rights become vested after 5 years of service.

The "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date. The measure, which is the actuarial present value of credited projected benefits, is intended to help users assess the system's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due and make comparisons among employers. The Lottery is unable to determine the actuarial present value of credited projected benefits and net assets available for benefits since the information is available only on a total State basis, not agency basis.

The pension benefit obligation at June 30, 1991, for the State system as a whole was $1,173,852,092. The system's net assets available for benefits at cost on June 30, 1991, were $919,474,377 leaving an overall unfunded pension benefit obligation of $254,377,715. The Lottery's 1991 contribution represented approximately .01 percent of total June 30, 1991, contributions required of all participating entities. The Lottery is not responsible for any state system unfunded liability.

Ten-year historical trend information showing the State system's progress in accumulating sufficient assets to pay benefits when due is presented in the system's June 30, 1991, annual financial report. Only the first two years of the required 3-year trend information is available.

Note 6: Deferred Compensation Plan - The Lottery's employees are eligible to participate in the State of Montana's deferred compensation plan. The State of Montana administers the plan by contractual arrangement with Nationwide Insurance.

Note 7: Contractual Arrangements -

A. Instant Tickets - The Lottery has signed agreements to purchase instant game tickets from Dittler Brother, Inc., through March 9, 1992. This contract may be terminated by the Lottery with proper notification.

B. Computer Hardware and Software Maintenance - The Lottery has signed an agreement for computer hardware and software maintenance from Stratus Computer, Inc. for $4,702 per month.

C. On-line vender - The Lottery has signed a contract with Control Data Corporation to provide on-line terminals, central computers, and telecommunication network through November 9, 1994. The contract provides for payments to be based on a percentage of weekly sales.

Note 8: **Prize Contingencies** - Big Spin Jackpot - Certain Big Spin prizes awarded are payable to the winners in annual installments of 17 to 20 years, with the first payment being made by the Lottery. The Lottery has entered into agreements with an insurance company under which purchased annuities will provide payments corresponding to the Lottery's obligation to these prize winners. Because it is the intent of the Lottery that the insurance company will make future installment payments directly to each prize winner, neither the present value of the annuities nor the present value of future payments are reflected in the accompanying financial statements. The Lottery would be liable for such future payments in the amount of $3,987,647 if the insurance company was to default on their payments.

Note 9: **Multi-State Lottery Receivable** - As a member of the Multi-State Lottery Association (MUSL) and the Lotto*America game, the Lottery is required to contribute to a prize reserve fund maintained by MUSL. This fund is to be used only in the event of an unanticipated prize claim. It is an insurance fund intended to protect the member lotteries against the liability that could result from a system failure at one of the member lotteries. All money paid to this fund, as well as the interest earned on the Lottery's share of the fund, would be returned to the Lottery upon leaving MUSL (assuming that no unanticipated prize claims have been paid).

The Lottery contributes to the reserve fund through the 45 percent set-aside for prizes. In addition the Lottery was required to contribute for its portion of the reserve fund accumulated since the start of the Lotto*America game. The Lottery made this payment in full as of June 1990, through an additional 2 percent of drawing revenue rather than making a lump sum payment. Payments made to the reserve fund are considered a portion of the prize expense associated with the on-line game.

The unreserved accounts were created by the MUSL Board in July 1990. The purpose of this account was to record interest earned on the prize reserve fund when the prize reserve fund balance is not below the ceiling amount. The amounts in the unreserved accounts can be used as approved by the Board.

As of June 30, 1991, the MUSL prize reserve fund had a balance of $20,827,230 of which the Montana Lottery's combined reserve and unreserved funds were $542,809.

Note 10: **Lotto*America Prizes and Investments** - Prizes awarded to Lotto*America grand prize winners are paid 20 annual installments. The Multi-State Lottery purchases United States Treasury zero coupon bonds to finance the remaining installments of the grand prizes. The bonds are purchased in the name of the Montana State Lottery, but are held at the Multi-State Lottery.

As the bonds mature, the proceeds are forwarded to the Montana State Lottery and distributed to the grand prize winners on the anniversary date of each win.

As of June 30, 1991, Multi-Sate Lottery holds United States Government zero coupon bonds for the Montana State Lottery with a par value of $11,259,542.50. The approximate market value of these same bonds as of June 30, 1991, is $5,720,940.76. The Montana State Lottery has three Lotto*America winners as of June 30, 1991. The combined total of future prize payments owed to the winners as of June 30, 1991, is $11,258,000. The total annual payments due over each of the next five fiscal years is $605,000 per year. The present value of the future prize payments approximate the current market value of the bonds held for the Montana State Lottery.

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Commissioners
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Helena, Montana

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS BASED ON THE AUDIT OF MONTANA STATE LOTTERY FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS ISSUED BY THE GAO

We have audited the financial statements of Montana State Lottery as of and for the year ended June 30, 1991, and have issued our report thereon dated September 13, 1991.

We conducted our audit in accordance with generally accepted auditing standards, and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with State and Federal statutes and regulations applicable to the Montana State Lottery is the responsibility of the Lottery's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Montana State Lottery's compliance with certain provisions applicable to State and Federal statutes and regulations. However, it should be noted that our objective was not to provide an opinion on overall compliance with such provisions.

The results of our tests indicate that, with respect to the items tested, the Montana State Lottery complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested nothing came to our attention that caused us to believe that the Montana State Lottery had not complied, in all material respects, with those provisions.

This report is intended for the information of management and legislative audit committee. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Douglas Wilson & Company, PC

September 13, 1991

Douglas Wilson & Company, PC
Established 1913

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Commissioners
Montana State Lottery
Helena, Montana

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL STRUCTURE RELATED MATTERS NOTED IN THE MONTANA STATE LOTTERY FINANCIAL STATEMENT AUDIT CONDUCTED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

We have audited the financial statements of Montana State Lottery for the year ended June 30, 1991, and have issued our report thereon dated September 13, 1991.

We conducted our audit in accordance with generally accepted auditing standards, and Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of Montana State Lottery for the year ended June 30, 1991, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

The management of Montana State Lottery is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories:

1. Cash Receipts/Receivables/Revenue
2. Program Fund Expenditures/Assets/Payables/Expenses
3. Payroll/Related Liabilities
4. Fixed Assets Depreciation/Intangibles Amortization

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For all of the control categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above.

This report is intended for the information of management, and legislative audit committee. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Douglas Wilson & Company, P.C

September 13, 1991

Recommendation:

We recommend that the Montana State Lottery develop an accounting policy and procedure manual.

Action (per 6/30/90 report):

The Lottery is actively developing accounting policies and procedures documents to reduce to writing the policies and procedures that are in place. The documents are in different stages of completion.

Status (as of 6/30/91):

The Lottery has put in writing specific accounting procedures that are currently in place. This manual is not complete; however, the Lottery continues to update as time permits.

Current Auditor Comment:

The Lottery has written accounting policies and procedures in many key areas such as year-end ticket inventory procedures, ILS, OLS, accounts payable, and others. There are still some minor policies and procedures that the Lottery must put into writing.